DON Approach to Audit Readiness and Validation

4 November 2004

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Preparing for Audit

- Audits are a rigorous process
- Preparing for the DON Audit (with the goal of passing) will be equally as rigorous
  - History of Disclaimers
  - OUSD(C) Business Rules changed the game - Resolving known deficiencies is not enough to assert RFA
- Starting with the Business Rules, the DON developed an approach to “validate” audit readiness and tested on selected GF lines
- The DON Approach is now the DOD Standard

DON Validation Overview

Financial Statement Line Items

GAO/PCIE FAM

OSD/IG Checklist

FISCAM/ SAS 70/88

Internal Control Questionnaire

Financial Transactions

Process Flows and Narratives

Internal Controls Evaluation

Supporting Documents

Systems Documentation

Process Improvement

New Deficiencies

Miscellaneous Findings

Assertion

Development of the DON Approach to Audit Readiness

- Distributing the Validation Effort
  - Drafted Preliminary Guidance
    - Document Business Events and Processes (including Systems) that impact line items on the financial statements
    - Assess Risks and Identify Controls
    - Substantiate Balances and be able to produce Audit Evidence within 48 Hours
  - Training and Resources Will Be Provided
- Benefits to “Validating” Audit Readiness
  - Proper Accounting for Business Transactions
  - Connect Business Events to Financial Statements
  - Identify New Deficiencies (previously unknown)
  - Prepare for Audits
  - Provide a Basis for Asserting RFA

What's Following

- Demonstrate the DON Validation Approach
- Discuss Internal Controls, Process Documentation, and Evidential Matter
- Training Approach

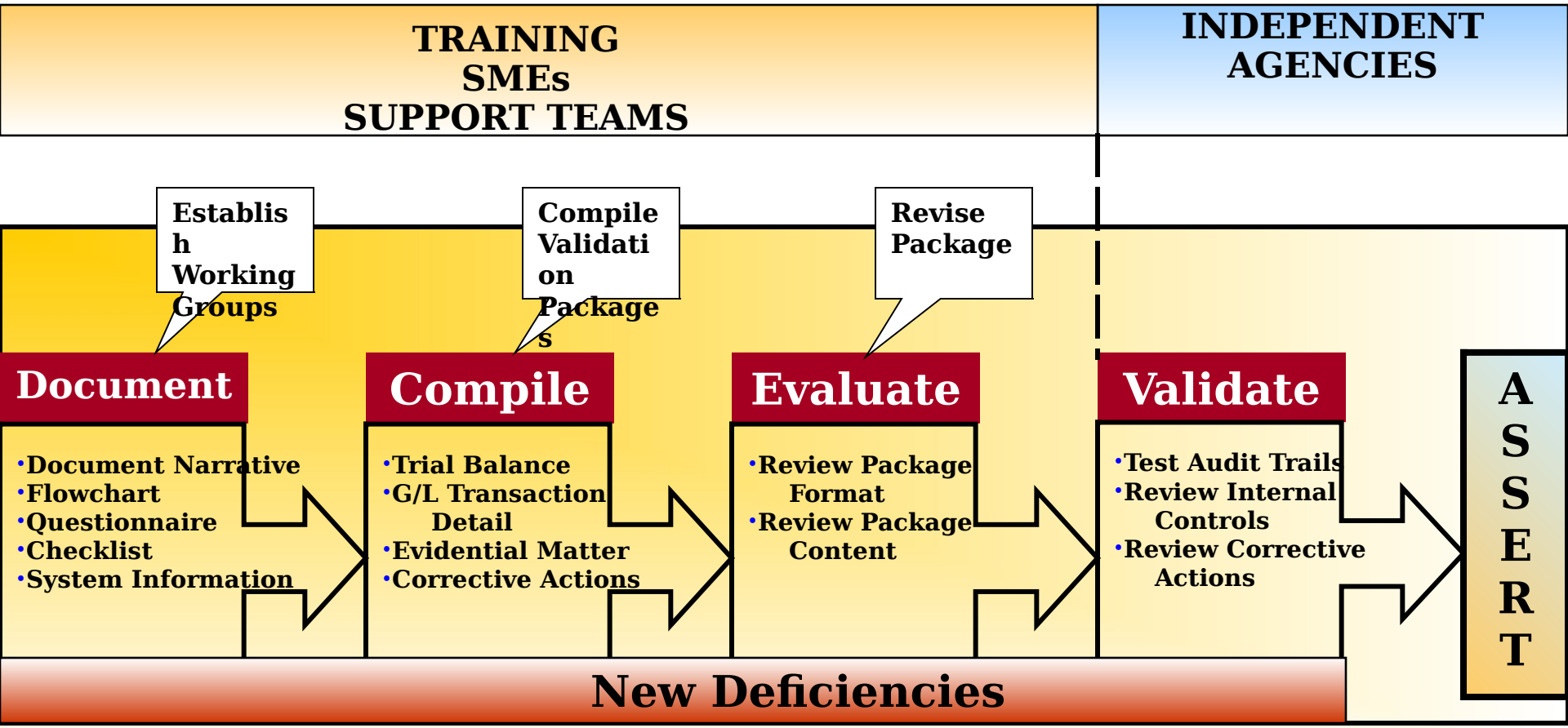
Current Financial Statement Situation

- Unable to obtain an unqualified audit opinion
  - Entity-wide systemic deficiencies
    - Financial systems
    - Business processes
  - Material weaknesses exist due to
    - Insufficient General Ledger and internal controls
    - Lack of sufficient audit trails
    - Inconsistent financial management practices

Objective

- To ensure a sustainable entity-wide "paradigm shift" towards good financial management and audit readiness
  - Build a foundation of internal control and accountability across commands
  - Empower major commands with financial data and business process ownership
  - Engage the support of line managers through training programs
  - Document our audit readiness

Validation Process



DON Validation Approach

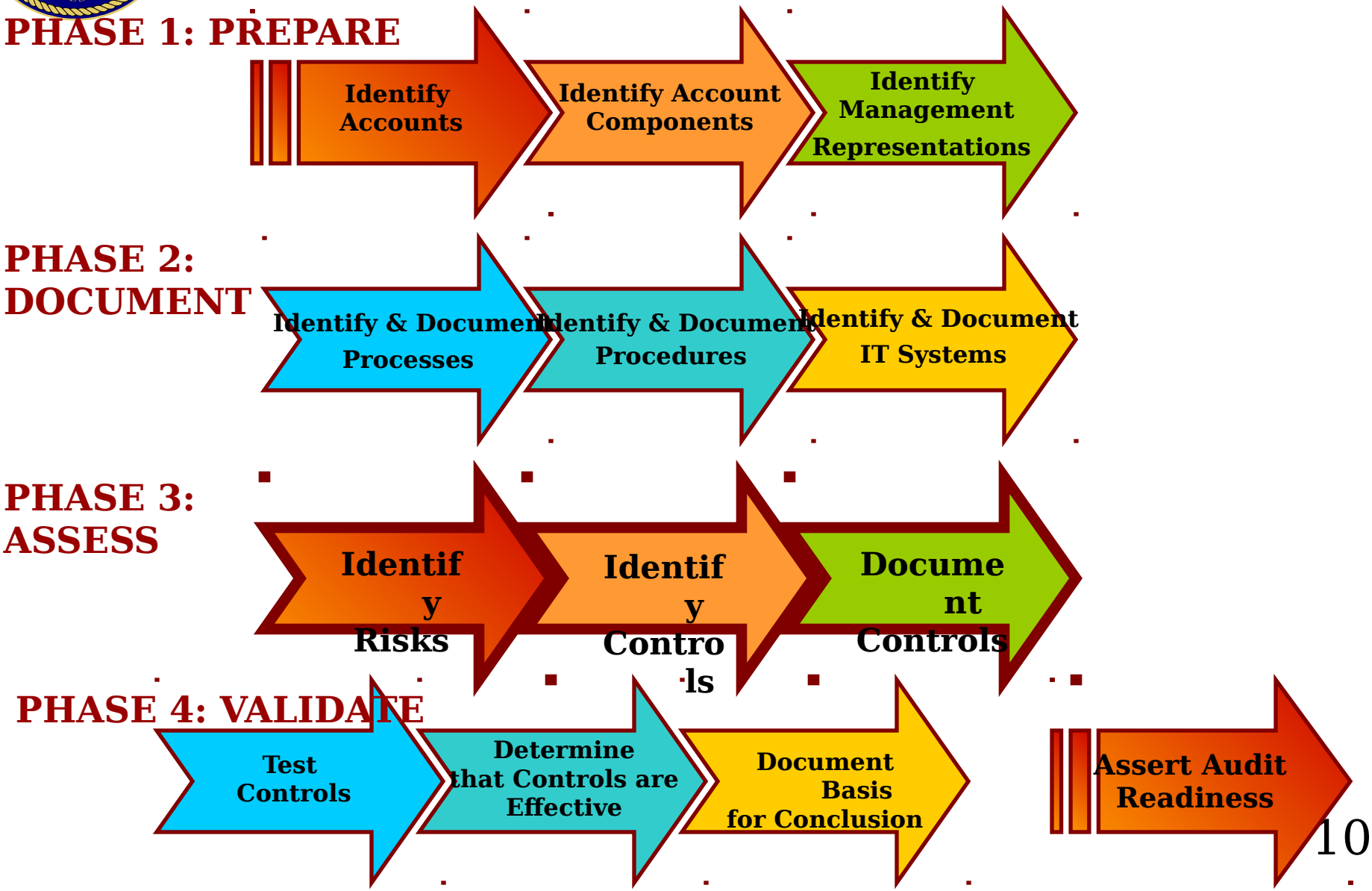
Dominant Guidance

- **Government Accountability Office (GAO)/President's Council on Integrity and Efficiency (PCIE) Financial Audit Manual**

Reference Guidance

- DoD Federal Management Regulations (FMR)
- Federal Managers' Financial Integrity Act (FMFIA)
- OUSD(C)/IG Business Rules
- GAO Government Auditing Standards (2003 Yellow Book)
- GAO Financial Information Systems Control Audit Manual (FISCAM) & SAS 70/88
- OMB Bulletin 01-02, Audit Requirements for Federal Financial Statements
- Federal Accounting Standard Advisory Board (FASAB) Concepts and Standards
- OMB Bulletin 01-09, Form and Content of Agency Financial Statements

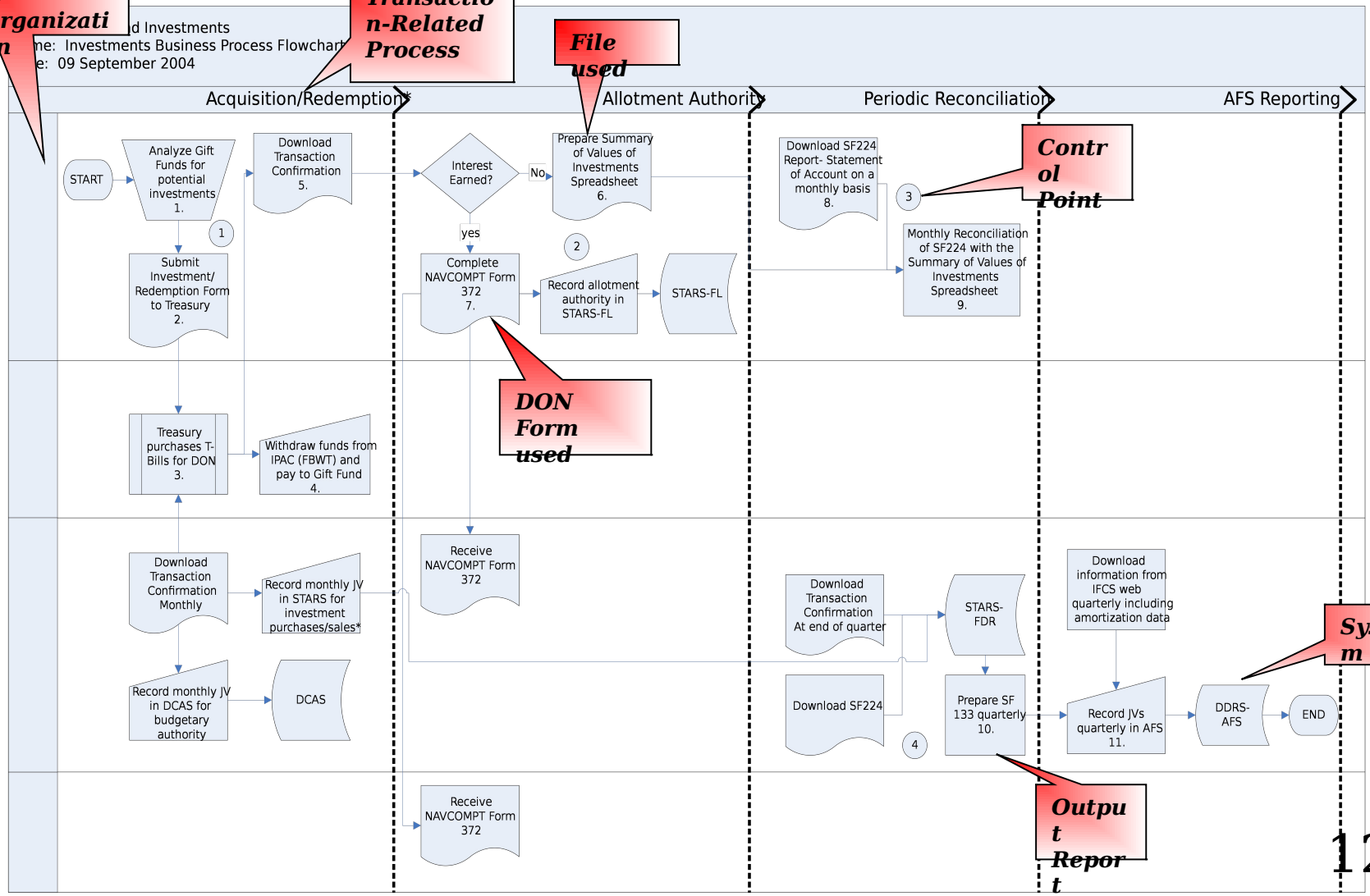
DON Validation Approach Con't.



Processes & Procedures Documentation

- Identify and document the procedures and processes for deriving the balance(s) being asserted.
- Commands and DFAS prepare sufficient documentation including narrative memorandums and flowcharts to illustrate the business process for the line item.
- Elements to include:
  - Initiation of Transactions
  - Systems Involved
  - Output Reports
  - Control Points
  - Audit Trail
- Narratives and Flowcharts should demonstrate the relationship (i.e. audit trail) between the line item and common business process.

Business Process Flow Chart


Responsible Organization
Transaction-Related Process
File used
Control Point
DON Form used
System
Output Report
d Investments
me: Investments Business Process Flowchart
e: 09 September 2004
Acquisition/Redemption
Allotment Authority
Periodic Reconciliation
AFS Reporting
START
Analyze Gift Funds for potential investments 1.
Download Transaction Confirmation 5.
Interest Earned?
No
Prepare Summary of Values of Investments Spreadsheet 6.
yes
Complete NAVCOMPT Form 372 7.
Record allotment authority in STARS-FL
STARS-FL
Download SF224 Report- Statement of Account on a monthly basis 8.
Monthly Reconciliation of SF224 with the Summary of Values of Investments Spreadsheet 9.
Submit Investment/ Redemption Form to Treasury 2.
Treasury purchases T-Bills for DON 3.
Withdraw funds from IPAC (FBWT) and pay to Gift Fund 4.
Download Transaction Confirmation Monthly
Record monthly JV in STARS for investment purchases/sales*
Record monthly JV in DCAS for budgetary authority
DCAS
Receive NAVCOMPT Form 372
Receive NAVCOMPT Form 372
Download Transaction Confirmation At end of quarter
STARS-FDR
Download SF224
Prepare SF 133 quarterly 10.
Download information from IFCS web quarterly including amortization data
Record JVs quarterly in AFS 11.
DDRS-AFS
END

What is Control?

- A control provides reasonable assurance that what should happen does happen.
- Controls help program managers achieve desired results through effective stewardship of public resources.
- Controls are part of every process or activity performed throughout the day. They include: Policies, Rules, Laws, and Procedures.
- Controls can be automatically performed by systems or performed manually by the people involved in the process.
- Examples of controls include everything from a manager's signature on a timecard to pin numbers required to withdraw money from an ATM.

Internal Control Con't.

- Internal Control Should:
  - Ensure obligations and costs are in compliance with applicable law
  - Ensure funds, property, and other assets are safeguarded against waste, loss, and unauthorized use
  - Ensure revenues and expenditures applicable to agency operations are accounted for and properly recorded
  - Be an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing

Source: FMFIA (1982)

GAO's Standards for Internal Control

The Five GAO standards:

- **Control environment:** Sets up the structure and tone in which the command operates.
- **Risk assessment:** Allows entities to target high-risk areas and focus resources where the greatest exposures exist. It requires identifying, analyzing, and managing internal and external risks that may affect achievement of an organization's mission.
- **Control activities:** Establishes policies, procedures, and mechanisms to enforce management directives and achieve organizational objectives.
- **Information and communication:** Should be relevant, reliable, and timely and flow to appropriate personnel.
- **Monitoring:** Should assess the quality of performance over time and ensure audit findings are promptly resolved.

Internal Control Tools

- **GAO Checklist**
  - Uniformity
  - Consistency
  - Quality Control
- **Internal Control Questionnaires**
  - Control Objectives
  - Control Activities (e.g. Segregation of Duties, Access Restrictions, Physical Control Over Access to Records)

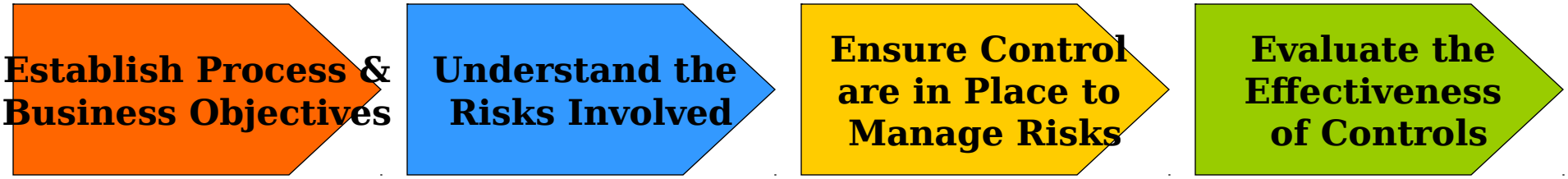
Checklist -
Assistant For Administration to the Under Secretary of the Navy
Balance Sheet - Investments

Investments in federal (i.e., treasury) securities include (1) nonmarketable par value Treasury securities, (2) market-based Treasury securities expected to be held to maturity, (3) marketable Treasury securities expected to be held to maturity, and (4) securities issued by other federal entities. Nonfederal securities include those issued by state and local governments, private corporations, and government-sponsored enterprises. (SFFAS 1, par. 62; OMB Bulletin 01-09, p.20, section 3.3)

Department of the Navy General Gift Fund	Yes, No, or, N/A	Explanation
What organizations are holding DON Investments? Are investment subsidiary ledgers maintained that capture the name, type, amount,	YES	AAUSN invests for the Navy General Gift Fund, which is comprised of several trust funds and or allotments, see Tab 1 WP 5/52. An investment summary portfolio is maintained per investment. See Tab 1 WP 6/52. Treasury confirmation statements are also maintained per investment.
	Yes	See Tab 1 WP 6/52
	No	Not in STARS, premiums and discounts are recorded as expenditures or collections on the NAVCOMPT 372

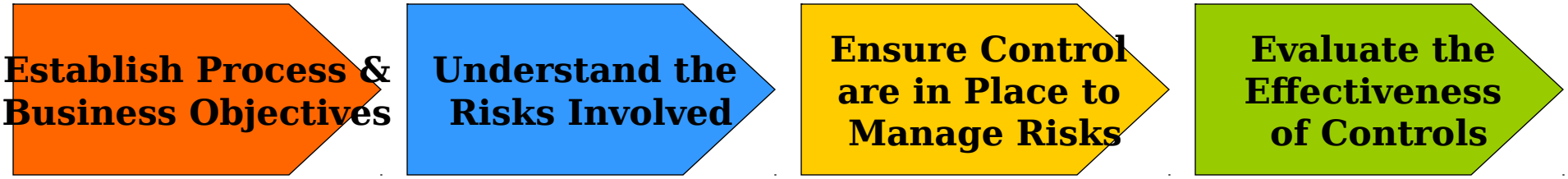
Financial Statement Line Item:	**Investments**		
Financial Statement:	**Balance Sheet, DON General Fund**		
Line Item Balance (FY 2003, Qtr 4)	**$9,801,000**		
Intragovernmental:			
Management Assertion 1:	**Existence or Occurrence**		
Control Objective	**Internal Control Activity**	**Y, N, N/A**	**Explanation**
1. Recorded investments should be supported by appropriate detailed records that are accurately summarized and reconciled to the account balance.	1. Do periodic reconciliations occur between the investments account balance and the trust fund portfolios? (DoD FMR Vol. 4, Chapter 7, para. 070203F)	Y	AAUSN and USNA perform reconciliations on a monthly basis. See workpaper(s) Tab 1 WPs 4/52, 11/52.
	2. Do periodic reconciliations occur between the investments account balance and the trust fund portfolios whenever there is a: (a) change in trust fund managers or other employees having access to the securities? (DoD FMR Vol. 4, Chapter 7, para. 070203F) (b) substantial change (e.g., addition, disposition, or replacement) to the composition of the trust fund portfolio? (DoD FMR Vol. 4, Chapter 7, para. 070203F)	Y	AAUSN and USNA reconciliation procedures are in place and appear to be operating effectively in the event any changes to the trust fund responsibilities or portfolios should occur (as described in 2(a) and 2(b)).
2. Access to investment records should be permitted only in accordance with laws, regulations, and management policy.	1. Do controls exist to ensure access to investment records is in accordance with laws, regulations, and management policy?	Y	Nothing came to our attention that led us to believe that inappropriate access to investment records occurs.
	2. Does management policy include provision for: (a) dual signatures or authorizations to obtain release of securities from safekeeping? (b) periodic inspection or confirmation of securities?	Y	U.S. Treasury's Bureau of Public Debt has custodial responsibilities and sends DON Transaction Confirmations. See workpaper(s) Tab 3 WPs 5/54, 10/54, 39/54, 44/54, 46/54.
3. Recorded investment transactions, underlying events, and related processing procedures should be authorized by federal laws, regulations, and management policy.	1. Do controls exist to ensure recorded investment transactions, underlying events, and related processing procedures are authorized by federal laws, regulations, and management policy?	Y	See workpaper(s) Tab 1 WPs 32/52 – 49/52.

Internal Control Assessment


Establish Process & Business Objectives
Understand the Risks Involved
Ensure Control are in Place to Manage Risks
Evaluate the Effectiveness of Controls

- Control Risk
- Business Type Risks
  - Financial Risk – Loss of assets or available operating or capital budget
  - Human Risk – Management and staff not sufficient to meet needs and mission of organization
  - Reputation Risk – Negative public opinion
  - Technology Risk – Systems and technology tools, in design and operation, do not allow achievement of mission
  - Strategic Risk – Mission/strategic plan does not support overall DON objectives
  - Operational Risk – Operational policies/procedures/instructions do not sufficiently control business to all achievement of mission
  - Environmental Risk – Operations negatively impact the environment

Internal Control Assessment Con't


Establish Process & Business Objectives
Understand the Risks Involved
Ensure Control are in Place to Manage Risks
Evaluate the Effectiveness of Controls

- Effectiveness of Internal Control
  - The more effective the internal control, the more assurance it provides about the reliability of the accounting data and financial statements.
- Benefits
  - Visibility of weaknesses
  - Ability to anticipate potential and systemic weaknesses
  - Compliance with laws and regulations

Line Item Transaction Detail

- Transaction detail and supporting information from feeder systems should be available for all transactions that make up the financial statement line item balance(s) being asserted.
  - Ensure that the total of the detail should equal the balance of the line item.
  - Balances should be verified (e.g. recalculating, crossfooting, and tracing amounts).

Line Item Transaction Detail Con't

DDRS Account Drill Down

- Transaction Detail for Investments

Exhibit 1

Department of Defense
Department of the Navy
CONSOLIDATED BALANCE SHEET
As of September 30, 2003 and 2002

Drill down account balance

	2003 Consolidated
1. ASSETS (Note 2)	
A. Intragovernmental:	
1. Fund Balance with Treasury (Note 3)	
a. Entity	$ 78,191,852,145.69
b. Non-Entity Seized Iraqi Cash	0.00
c. Non-Entity-Other	223,224,564.62
2. Investments (Note 4)	9,801,358.90
3. Accounts Receivable (Note 5)	496,852,280.60
4. Other Assets (Note 6)	187,865,285.84
5. Total Intragovernmental Assets	79,109,405,635.65

Exhibit 2

Fiscal year 2003 quarter 4 — Export to

BALANCE SHEET
1A2 - Investments (Note 4)

AT17 - Navy General Fund

2003 Consolidated

Navy

AT17AM4 - Other

SGL	Enty	Gov	Fnd	Exch	Fin	Other Attributes	Trial Balance Amount	Eliminations
1340	E		F			Investments	$94,902.05	$0.00
1610	E		F			Non-Marketable Market Based	$9,627,000.00	$0.00
1612			F			Non-Marketable Market Based	$229,895.01	$0.00
1613						Non-Marketable Market Based	($150,438.16)	$0.00
						Total AT17AM4 - Other	$9,801,358.90	$0.00
						Total Navy	$9,801,358.90	$0.00

Drill down on SGL

$9,801,358.90 $0.00

Report Line Total $9,801,358.90

Exhibit 3

Fiscal year 2003 quarter 4 — Export to Excel

BALANCE SHEET
1A2 - Investments (Note 4)
1610EF___Non-Marketable Market Based

AT17 - Navy General Fund
Navy - Other
2003 Consolidated

AT17AM4_8716 Department of the Navy General Gift Fund

Trial Balance Amount	Eliminations	Elim Program	JV Code
$2,435,000.00			

Total $2,435,000.00
AT17AM4_8716

AT17AM4_8733 US Naval Academy General Gift Fund

Trial Balance Amount	Eliminations	Elim Program	JV Code
$7,192,000.00			

Total $7,192,000.00
AT17AM4_8733

$9,627,000.00
Total
Navy - Other

Evidential Matter

- Evidential Matter consists of the underlying account data and all corroborating information to be made available to auditors.
- GAO Yellow Book requires that relevant, sufficient, and competent evidence be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements being audited.

Evidential Matter Con't.

- Types of Evidence
  - Physical (e.g. Direct Inspection & Observation)
  - Documentary (e.g.Laws & Regulations, Contracts, Inventory Reports, Purchase Orders)
  - Testimonial (Inquires, Interviews, Questionnaires)
  - Analytical (e.g. Comparisons & Ratios)

Evidence

Fiscal year 2003 quarter 4 — Export to Excel

BALANCE SHEET
1A2 - Investments (Note 4)
1610EF___Non- Marketable Market Based

AT17 - Navy General Fund
Navy - Other
2003 Consolidated

AT17AM4_8716 Department of the Navy General Gift Fund

Trial Balance Amount	Eliminations	Elim Program	JV Code
$2,435,000.00			
Total $2,435,000.00			

AT17AM4_8716

AT17AM4_8733 US Naval Academy General Gift Fund

Trial Balance Amount	Eliminations	Elim Program	JV Code
$7,192,000.00			
Total $7,192,000.00			

AT17AM4_8733

Total $9,627,000.00
Navy - Other

Department of the Navy General Gift Fund
Summary of Values of Investments
15-Aug-03

(AAUSN spreadsheet)

Date	Proj/ Alloc. No.	Face (Par) Value	Int. Rate	Cost	Maturity Date	Semi-Annual Interest/Disc.*	Payment Dates
2/28/2003		$1,794,000.00		$1,824,554.06	2/29/04	$25,910.00	8/31-2/29
	58037	$184,800.00					
	58046	$11,510.00					
	58048	$6,625.00					
	58090	$64,200.00					
	58133	$10,520.00					
	58133	$14,115.00					
	60133	$63,850.00					
	61133	$31,650.00					
	63133	$22,655.00					
	65133	$9,820.00					
	58152	$857,795.00					
	60152	$241,710.00					
	61152	$18,650.00					
	60117	$206,070.00					
6/30/2003	61117	$485,000.00	2.875	$490,866.41	6/30/04	$6,971.88	12/30-6/30
8/15/2003		$156,000.00	4.75	158,851.88	2/15/04	$3,705.00	8/15-2/15
	59152	$147,225.00					
		$8,775.00					
		2,435,000.00		2,477,272.35		37,586.88 (1)	

SF 133

Report on Budget Execution and Budgetary Resources

Agency: DOW — Bureau: 8716 — Dept of the Navy General Gift Fund

Description	Ch/Ch	20/20
Budgetary Resources:		
1 Budget Authority		
A Appropriation	A 1,338,903.67	194,674.05
B Borrowing Authority	.00	.00
C Contract Authority	.00	.00
D Net Transfers, Current	.00	.00
E Other	.00	.00
2 Unobligated Balance		
A Brought Forward Oct. 1	1,498,853.42	3,240,325.04
B Net Trans of FY Balances	.00	.00
C Anti-c Trans of FY Bal	.00	.00
3 Spending Authority		
A Earned		
1 Collected	.00	.00
2 Receivable Fed Sources	.00	.00
B Change in Unfilled Orders		
1 Advance Received	.00	.00
2 W/O Fed Sources	.00	.00
C Anticipated for Rest of Yr		
1 Apy for Antic Orders	.00	.00
2 Without Advance	.00	.00
D Trans from Trust Funds		
1 Collected	.00	.00
2 Anticipated	.00	.00
4 Recoveries of PY Obligs		
A Actual	.00	.00
B Anticipated	.00	.00
5 Temporarily Not Available	.00	.00
6 Permanently Not Available		
A Cncl Rec/Wd-Year Accts	.00	.00
B Enacted Rescissions	.00	.00
C Capital Trans/Redist Dewt	.00	.00
D Other Authority Withdrawn	.00	.00
E Non-Exec to Execut Law	.00	.00
F Antic PYs Rest of Year	.00	.00
7 Total Budgetary Resources	2,727,762.09	2,435,000.00
Other Non-Budgetary Resources:		
A Cncl Rec/Wd-Year Accts	1,655,881.42	.00
B Cncl & Direct Obligations		
1 Subcategory 1	.00	.00
2 Subcategory 2	.00	.00
3 Subcategory 3	.00	.00
C Not Subject to Report	.00	.00
D Reimbursable Obligns	.00	.00
8 Unobligated Balance		
A Apportioned		
1 Balance Cncl Available	1,071,880.67	2,435,000.00
2 Anticipated	.00	.00
B Exempt from Apportionment	.00	.00
C Other Available	.00	.00
10 Canceling Bal Not Available		
A Apportioned Ctg Revisions	.00	.00
B Deferred	.00	.00
C Withheld Pending Recns	.00	.00
D Other	.00	.00
11 Total Budgetary Resources:	2,727,762.09	2,435,000.00
Memorandum of Amounts to Offset		
12 Change Bal, Net Oct 1	374,881.31	.00
13 Change Bal Not Recovered	.00	.00
14 Amount Bal. End of Period		
A Accounts Receivable(-)	.00	.00
B Unfilled Customer Orders		
1 Fed Sources W/O Advance	.00	.00
2 Fed Sources W/Advance	.00	.00
3 Non-Fed Sources W/Advance	.00	.00
C Undel/Fixed Orders(+)	.00	.00
D Accounts Payable(+)	993,135.07	.00
15 Outlays		
A Disbursements(-)	1,037,581.64	.00
B Collections(-)	.00	.00

		.00
		.00
		.00

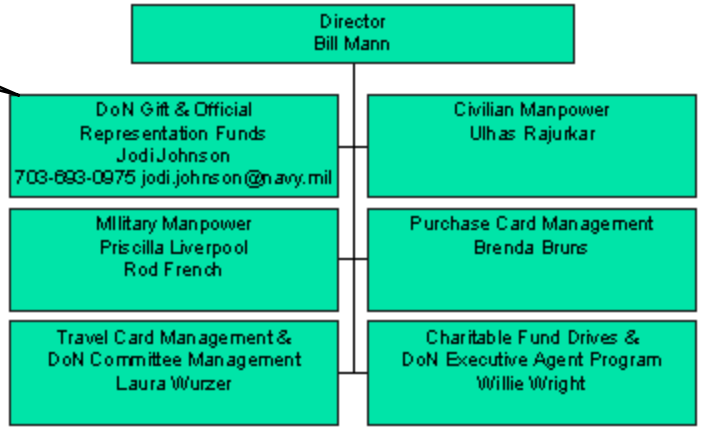
Organization Chart

AAUSN

http://www.hq.navy.mil/aausn/

POC title and contact information

AAUSN
Special Programs Division



System Documentation

- System Documentation Requirements
  - FISCAM/SAS 70/88 audit results
  - In the absence of a FISCAM or SAS 70/88 audit:
    - Description of major hardware, software, and telecommunication devices
    - Type of data produced and interfaces with other systems
    - Recent certifications and accreditations
    - System location and end users
    - Type, dollar value, and number of transactions processed
    - List of authorized users
    - Ongoing or planned reviews

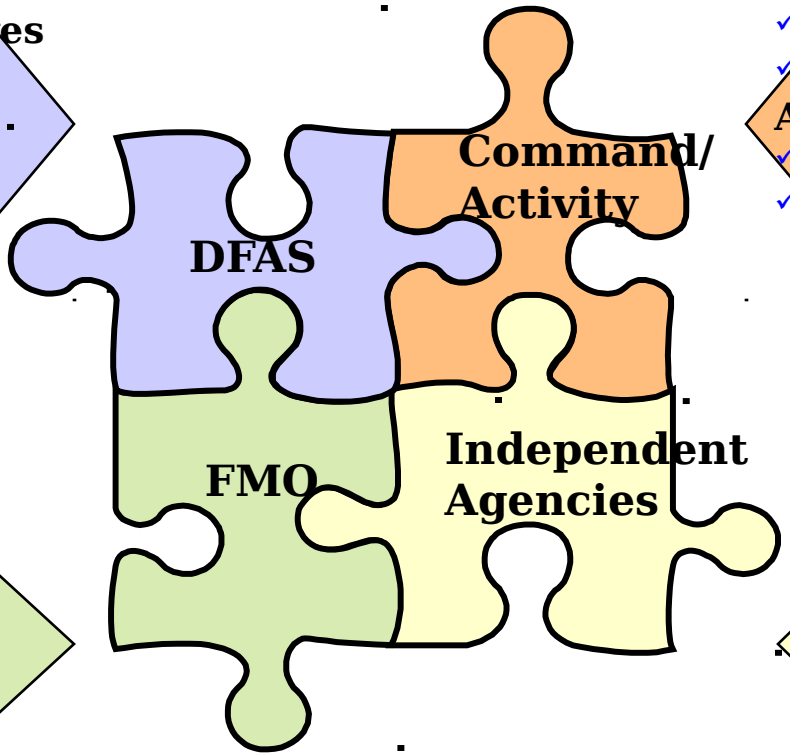
Entity Roles & Responsibilities

DFAS-CL/DFAS-KC

- ✓Process Flows & Narratives
- ✓Internal Control Assessment
- ✓Evidential Matter
- ✓Correction Actions

Commands/Activits & DFAS Field Sites

- ✓Process Flows & Narratives
- ✓Internal Control Assessment
- ✓Evidential Matter
- ✓Correction Actions



FMO

- ✓Validation & Assertion Coordination
- ✓Package Evaluation

Independent Agen

- ✓Entity Support
- ✓Validation

Ready for Assertion

DON Validation Package Guidance

- Package Content
  - Business Processes and Procedures – Narratives & Flow Charts
  - Internal Control Documents – Questionnaires & Checklists
  - General Ledger Transaction Detail
  - Evidential Matter
  - Organization Charts
  - System Documentation
- Package Format
  - Binder Structure
  - Workpaper Indexing/Page Numbering

Training Approach

- **Communicate Roles and Responsibilities**
  - Ensure Commands are Aware of Responsibilities
  - Eliminate Duplication of Efforts
- **Validation Package Content & Format**
  - Ensure a Consistent and Structured Methodology
  - Ensure Appropriate Evidential Matter
  - Reinforce Effective Systems of Internal Control and Accountability
- **How to Accomplish Training Approach:**
  - Distribute Guidance and Frequently Asked Questions
  - Provide Centralized Training Opportunities
  - Engage the Support of Line Managers through Training Programs

Next Steps

- Commands/Activities and DFAS
  - Review Validation Package Guidance
  - Identify Command Level POCs for Validation and provide to FMO by December 3rd.
  - Begin to plan for Validation effort (Feb/Mar)
  - Begin Documenting Processes and Procedures
    - Review and familiarize yourself with the GAO checklist for CFO Act compliance (http://www.gao.gov/special.pubs/01765G/)